CEAPRO INC.

Nature Enhancing Life™

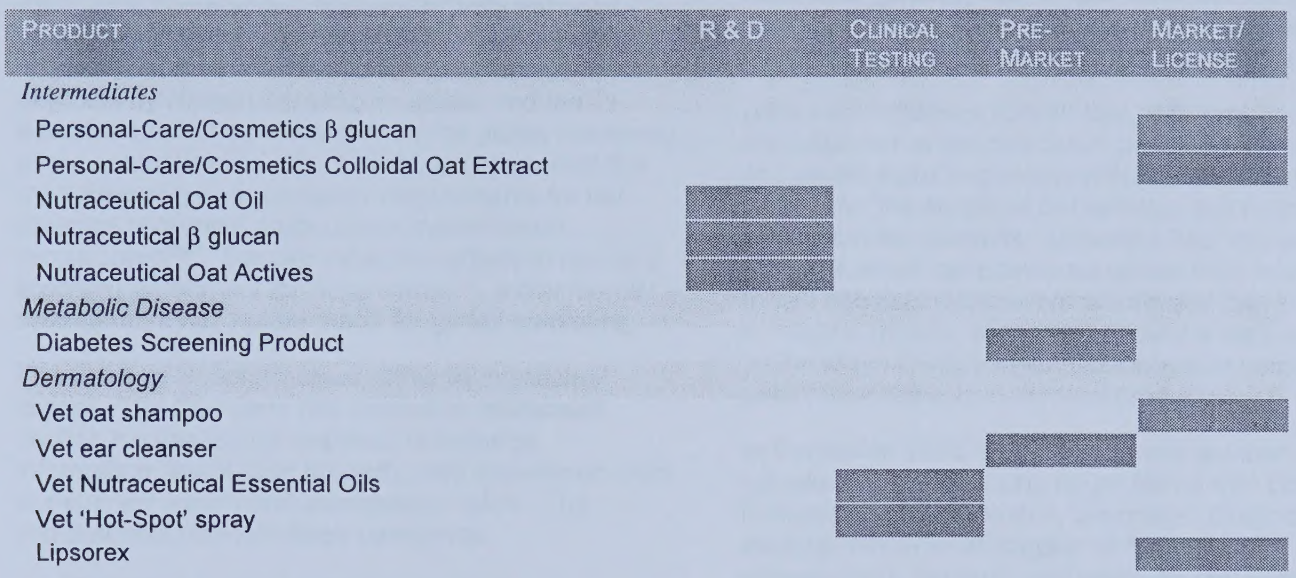
1998 ANNUAL REPORT

Ceapro Corporate Profile

Ceapro Inc. is an emerging biotechnology company whose products are already distributed to global markets. With the vision of Nature Enhancing Life™ the company utilizes proprietary core technologies for extraction, separation, and formulation of natural compounds to benefit human and animal health.

Table of Contents

Product Pipeline



1998 Significant Events

January	Health Canada approval to manufacture and sell the Accuscreen for the "Screening of type 2 diabetes and impaired glucose tolerance"
	Ceapro Advanced Separation Technology (CAST) patent application filed
February	US patent for 'Lipsorex' notice of allowance issued
March	Financial restructuring plan approved by banks and creditors
May	New β glucan production method patent application filed
	Saskatchewan Government Growth Fund takes control of Canamino
June	First shipment of animal health product
	Lipsorex® licensed to Canderm Pharma
August	Launch of 'Dr. Redmond's Oat Shampoo', Tokyo, Japan
September	Canamino sales for 1998 reach $1.7 million (9 months) vs. $2.1 million in 1997
October	Private placement for **$1,998,000** closed
	Repayment completed of bank loan for $1 million plus interest
	Canamino demonstration plant closed
December	Penetration of 20% of Japanese veterinary clinic

Message to Shareholders

I am pleased to report Ceapro has worked through the challenges of 1998 to emerge revitalized and with renewed commitment to our mission. We have completed a new foundation on which to build.

The year saw several important developments. We streamlined operations, reduced overhead, and retired bank debt. We developed three new and efficient separation technologies that significantly enhance margins and efficiency of production. We achieved major milestones with the launch of our animal health products by Nippon Zenyaku in Japan, and the establishment of a partnership for the global marketing of our cosmetic products. Finally, we completed the manufacturing and regulatory requirements for our diabetes screening product now trademarked 'Accuscreen™'. Despite extensive efforts to secure a licensing agreement for Accuscreen™, a commercial arrangement has not be made for global marketing.

The value of Ceapro resides within its intellectual capital. The Company has extensive intellectual capital: the intellectual material, knowledge, information, intellectual property, and experience used to generate wealth and shareholder value. The competencies fall into three categories:

1. Extraction and separation technology
2. Applied technology, formulation skills, and biomedical expertise
3. Market data, entry strategies, and growth tactics

The work in 1998 and on-going mission is to realize the value in and continue the growth of our intellectual capital.

At the end of 1998 we defined a new mission statement:

Ceapro Inc. is a technology-driven company, developing and utilizing core technologies to supply premium, highly differentiated, and natural intermediates to the life sciences and personal care industries

To fulfil our mission we have downsized and restructured the company.

Strategic Collaborations
Ceapro has stated that it intends to pursue corporate collaborations to lower expenses and take advantage of expertise outside of skill sets.

During 1998 we extended our value-chain. Our global partners now include internationally recognized leaders of agribusiness, personal care, manufacturing, and research.

In June Lipsorex® was exclusively licensed to Canderm Pharma of Montreal. Canderm, Canada's largest independent skin-care company, specializes in cosmeceuticals, ethical dermatologicals, and wound care products. With eleven sales representatives and 45 brokers across Canada, Canderm is able to devote the necessary marketing resources to Lipsorex® needed to generate sales. Canderm will pay Ceapro an 8% royalty on sales and has first right of refusal to US and European licenses for the next four years.

Ultravena Industries (Green Bay, WI), the manufacturer of oat powdered gloves for the medical and dental industries restated their commitment to Ceapro for the supply of oat extracts and proprietary oat extract formulations. Ultravena has lobbied the FDA to exempt oat-powdered gloves from legislation to ban powders such as cornstarch and talc from use in medical gloves. Independent clinical data verified by the Mayo Clinic support the lobby and validate the uses of oat extracts in medical products.

In December 1998, Ceapro achieved another major milestone in commencing negotiations with Dragoco Gerberding of Holzminden, Germany. Dragoco is a leading international supplier of fragrance compositions, flavours, and cosmetic raw materials and active ingredients. Dragoco's success has been achieved through a commitment to research, creation of new products and processes, a dedication to quality and an effective marketing approach which focuses on the development of long term partnerships.

A marketing and distribution agreement was reached in February 1999 between Ceapro and Dragoco. Ceapro provides Dragoco with a broader range of products and, therefore, an opportunity to obtain a larger share of the business, particularly with larger multinational cosmetics companies.

Canamino
On March 27th, 1998 the Saskatchewan Government Growth Fund (SGGF) issued notice of exercising the right to seize control of Canamino for non-payment of dividends. Despite continued efforts by Ceapro to resolve the issue, SGGF assumed control of Canamino on May 4th and subsequently placed Canamino into bankruptcy on October 5th. Throughout the summer of 1998, Ceapro co-operated with SGGF in the operation of Canamino and presented a series of proposals to ensure the continued operation of the plant. All Ceapro proposals were rejected. In June 1999, the Saskatchewan government paid $1.23M for the plant. With the closure of Canamino, Ceapro

wrote off its investment in Canamino in the amount of $6.6M.

Ceapro's viability was enhanced through the deployment of new technology and subsequent activation of alternative manufacturing operations. The new manufacturing processes encompass significant innovations that reduce costs and improve quality. Today, Ceapro is meeting not only its own demands for product, but has commenced supply to the global cosmetic industry.

Today, the production of β glucan and Colloidal Oat Extract takes place at Alberta Agriculture, Food, and Rural Development's facility at Leduc, Alberta. Manufacturing at this facility meets the projections for Dragoco's demand for the next 12-24 months. This will permit Ceapro to fine-tune processes and create cash flow before committing to the construction of a new facility.

Debt Restructuring

On March 2, 1998 Ceapro announced a plan for debt restructuring.

Financial institutions agreed to support the plan and subsequently creditors voted 95% in favour of acceptance. This action resulted in the issue of 1,305,500 shares and the obligation to pay $1.2 million in cash.

In October, 1998 the Company had repaid in total its $1.0M Bank Loan. This loan had been provided in part under the Agri-Value program.

Results of Operations

The Company incurred a loss of $14,259,673 during 1998 which included write-offs of the investment in Canamino and intangible assets of $12,344,443 for a net operating loss of $1,915,230. Compared to 1997 and eliminating Canamino operating results for 1997, Ceapro:

1. reduced its total expenses by 49% or $2,057,962;
2. reduced its R&D expenditures by 41% or $537,772 by concentrating on three projects as compared to eleven projects in 1997; and
3. reduced General & Administrative expenses by 60% or $1,734,393 through staff reductions and associated costs.

The expenditure reductions have continued into 1999, where 1999 expenditure levels are significantly below 1998 levels.

Looking Forward

The extraction technologies developed by Ceapro, although conceived for the production of oat intermediates, are applicable to other plants and cereal grains. The technologies, although complex, produce oat intermediates which are unparalleled in terms of quality and efficiency. In addition, the intermediates, colloidal oat extracts, and oat beta glucan surpass all or most competitive products with respect to performance.

CAST is the product of combining Ceapro processes with state-of-the-art technology co-developed by Ceapro and Agriculture and Agri-Food Canada Eastern Cereal and Oilseed Research Centre in Ottawa. Ceapro is currently negotiating a license for its share of the technology.

Ceapro has a clear vision, outstanding technology, strong partnerships, and the commitment to achieve success.

Sincerely

Robert A. Binnendyk
President and Chief Executive Officer

Dear Fellow Shareholder:

1998 was a difficult year for the Company, Management, and the Board. Despite the many setbacks, the Company has emerged with outstanding technology which was responsible for the partnership with Dragoco.

Management made sacrifices by deferring salaries during 1998 and into 1999 while continuing to make progress in moving the business forward.

The Board is optimistic about the future of the Company and is appreciative of the shareholder patience and of the patience exhibited by the creditors.

On behalf of the Board,

John Zupancic, P. Eng.
Chairman

Corporate Milestones

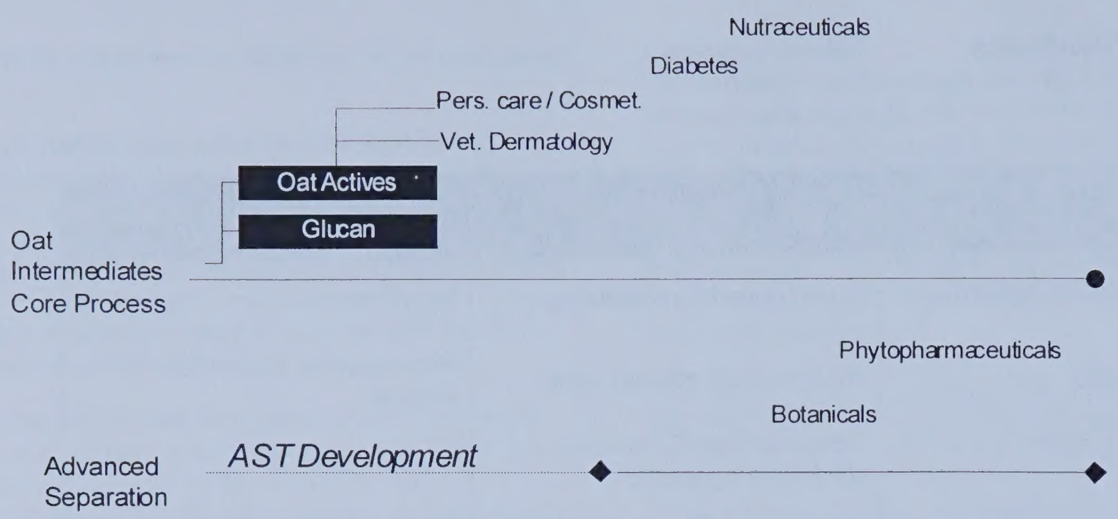
1998 Completed	1999 Projected	2000 Projected
Lipsorex Licensing Agreement	Commence Manufacturing	New Extracts
AST Technology	New extracts efficacy data	Nutraceutical Trials with partner
Colloidal Oat Extract Technology	Personal-Care/Cosmetics Marketing Agreement	
New β glucan technology	CAST licensing agreement	Demonstrate CAST to customers
Initial shipment companion animal health products	Companion animal health product licenses	Expand R&D Capability
Private placement	Accuscreen™ license agreement	Achieve Profitability
Repaid bank debt		

Strategic Objectives

Ceapro's primary goal is to enhance shareholder value.

The strategic objective will be accomplished by building value into the following three components

1. Intellectual Capital
2. Intermediates
3. Licenses and partnerships



Intellectual Capital

Ceapro has extensive intellectual capital, the intellectual material, knowledge, information, intellectual property, and experience that can be put to use to generate wealth and shareholder value. An integral part of the Ceapro business plan is the continued growth of intellectual capital.

Ceapro has a portfolio of patents, trade-secrets, and trademarks. Technology includes intellectual property developed by Ceapro staff or licensed to the Company from outside organizations.

The Ceapro strategy is to patent protect technology wherever possible. As a minimum, patent protection will be applied for in US, Canada, Great Britain, France, Germany, and Japan.

The Ceapro Patents may be divided into two fields:

- Process patents – comprising Ceapro's Core Technology
- Composition and Method of Use Patents – comprising Accuscreen™ and animal health products

Emanating from Ceapro's technology, are premium, highly-differentiated, natural products.

Core Technology

Since its formation, Ceapro has had an on–going programme of research investigating the extraction and efficacy of certain plant materials. The aim of this research is to produce standardized and more concentrated extracts than have been hitherto available and ultimately to identify the chemical compounds responsible for particular medical effects.

Two series of patents protect the core technology. The first series is the source of the *intermediates*, β glucan and Colloidal Oat Extract. The second series, Ceapro Advanced Separation Technology (CAST) is a leading edge process for the production of high-value extracts of natural materials and synthetic products.

The Ceapro intermediates produced through the new processes are stable, highly efficacious materials that meet the rigorous demands of life science and personal-care/cosmetics industries.

Ceapro's new production process manufactures high-quality β glucan in an efficient, highly controlled process. Compared to previous processes, this product:

- Utilizes lower cost feedstock (50% reduction)
- Enhances efficiency (10X)

Ceapro Oat β glucan combines health benefits with unique physical attributes of high concentration, exceptional solubility, and remarkable clarity.

β glucan: Linear 1→3; 1→4,β-D glucan is naturally occurring polymer of glucose found exclusively in cereal grains. This biologically active ingredient is responsible for regulating glycemia, reducing the risk of heart disease, promoting wound healing and stimulating immunity. The personal care and cosmetic industries utilize β glucan as a moisturising and conditioning agent for both skin and hair.

Ceapro also has introduced a new product, Colloidal Oat Extract for which the amount of active ingredient can be specified. Compared to previously available oat extracts, production of the new Ceapro product is dramatically over 30 times more efficient.

Ceapro Colloidal Oat Extract combines health benefits, standardized active ingredient concentration with unique physical attributes of exceptional stability and remarkable clarity.

Colloidal Oat Extract is a formulated preparation of the naturally occurring anti-irritants, sunscreens, and anti-oxidants found exclusively in oats.

FDA recognizes Colloidal Oatmeal as a Category 1 skin protectant. Human clinical trials conducted for Ceapro confirm the biological activity of the oat extract. The extract is a cornerstone of the Ceapro Animal Health products reducing itching and scratching. The personal care and cosmetic industries utilize Colloidal Oat Extract as a skin redness reducer and cofactor to sun-care products.

Ceapro Advanced Separation Technology

CAST is a new, leading edge process technology with broad applications in the life sciences industry. CAST is a patent pending technology for which Ceapro is negotiating a license with Agriculture and Agri-Food Canada for the isolation and purification of compounds from plants.

Biotechnology processes involve the separation of mixtures of biomolecules. This is an inherently difficult task due to the complexity of the mixtures and the close similarity between the target molecule and the impurities. Thus, large efforts and costs are spent on bioseparation/downstream processing. In the pharmaceutical industry for example, purification costs comprise between 40 – 80% of the total costs[1].

CAST is a low pressure, scaleable technique for the isolation and purification of compounds based in their ionic, aromatic and/or hydrophobic properties, using modified polysaccharide based, recyclable gels in aqueous-organic solvents.

CAST was developed with the goal of isolating groups of natural products. The technique has since been proven valuable in the isolation and characterization of individual compounds ranging from low molecular weight molecules to proteins.

[1] Data from the Swedish Centre for BioSeparation

The Ceapro Advanced Separation Technologies (CAST) were developed for the purification of botanical compounds. The technique has since been proven valuable in the isolation and characterization of individual compounds ranging from low molecular weight molecules to proteins. Therefore, CAST has significant potential in the field of medicine and biotechnology.

Specifically, the technology may be used for:

- The purification of drugs from botanical sources
- The purification of synthetic compounds from chemical syntheses

For a life science company in the biopharmaceutical business, CAST has the potential to be an adjunct to drug and vaccine development.

Specific examples of using CAST include:

- Antigen isolation and identification
- Monoclonal antibody development and screening
- Vaccine formulation and adjuvant development

With the right scientific and financial support, the innovations of CAST can open new markets and present a different approach to the business of Life Sciences.

For specialized applications, CAST can be fine-tuned by utilizing "Designer HIC gels". This new gel technology allows the resolution of molecules that are closely related.

Ceapro's strategy is as follows:

1. Utilize the technology
2. Sub-license the technology
3. Sub-license the production of "Designer HIC gels"

Accuscreen

The World Health Organization (WHO) has indicated that if current trends continue over the next 25 years, the number of diabetics will more than double, from 140 million to 300 million. The greater proportion of the increase is likely to occur in the developing countries, which are the communities that can least afford it. There is considerable scope, however, to lessen the economic and social burden resulting from diabetes provided that work continues in identifying the most effective diagnosis, prevention, and control policies.

The Accuscreen™ is a diagnostic aid for the early detection of Type 2 diabetes and impaired glucose tolerance.

The Accuscreen™ takes the form of an oat bar divided into ten individual wafers. Each wafer contains 5 g of carbohydrate of which approximately 80% is oat starch. The bar comprises oat starch (65%), fat (13%), and protein (15%), and contains a total of 350 calories.

The objective of this product is to provide a standardized meal to raise the blood glucose concentration and thereby to be a medical test of carbohydrate metabolism. To perform the test, a challenge is needed which reproducibly raises blood glucose by a large amount to an extent, which can be referenced to a normal physiological response.

The product provides the recommended balance of carbohydrate, fat and protein for a nutritious meal in a convenient, highly–standardized, solid wafer. The carbohydrate is pre–dominantly starch, which is the normal way of ingesting carbohydrate. In contrast, the carbohydrate in the present medical test, the oral glucose tolerance test (OGTT) is glucose, an abnormal and un–physiological way of eating carbohydrate. The inventors used the glycemic index to design their test to produce a high blood–glucose response. The glycemic index will be used as part of a quality assurance program of biological standardization. Clinical trials have established diagnostic reference ranges for the product. Because it is more physiological, the product yields test results which are more consistent and therefore more accurate than the 75g OGTT.

The product has regulatory approval as a medical device in Canada as a diagnostic, screening or monitoring device for glucose intolerance and Diabetes Mellitus Type 2. A patent application has been filed.

Compared to the OGTT, Accuscreen™ is more palatable, more accurate, takes less time, and involves fewer blood draws.

The opportunity for Accuscreen™ is to go beyond the currently accepted products and the currently accepted screening and diagnostic practices.

The accuracy and sensitivity of the Accuscreen™ provides the capability to identify patients with Impaired Glucose Tolerance (IGT), commonly referred to as pre-diabetes. This allows intervention to take place through diet, exercise, or drugs, to prevent the onset of diabetes and thereby alleviate the massive predicted costs of diabetes.

The Accuscreen™ received approval from the Canadian Health Protection Branch (HPB) in January 1998 for manufacture and sale to aid the diagnosis of Type 2 diabetes and Impaired Glucose Tolerance.

In the United States, the Accuscreen™ may be registered as a Class 2 medical device. Ceapro will work in conjunction with regulatory consultants to complete a 510*k* application claiming substantial equivalency to OGTT. This will fast–track the FDA approval process, allowing marketing to commence within 60 days of filing.

Ceapro has entered into a Letter of Intent with Goodstuff Bakeries of Vancouver for the production for this product. Trial runs have been undertaken and the product packaged for stability and quality control testing.

Ceapro's strategy is to license the marketing rights to the product or license the complete rights to the technology.

Animal Health Products

The companion animal sector of the global veterinary health market is valued at approximately US $3.3 billion and grew by 30% from 1994 to 1996. This companion animal sector represents approximately 20% of the total animal health market and it is expected that within the next five years, this sector will account for over 33% of the total animal health revenues and over 50% of the profits. This sector growth has been occurring through new product innovation, advances in veterinary medicine, which mirror human medicine, and due to consumer spending preferences in developed countries.

Ceapro has developed a family of dermal products that are based on oat extracts providing relief from skin irritation and both dermal and coat conditioning. The scientific evidence achieved through clinical trials, suggests that the Ceapro products provide benefits significantly ahead of any other products on the market today. Clinical trials were conducted in both Canada and Japan with equally positive results.

The growing use of counter–flea products will provide an opportunity for the highly effective Ceapro products which not only protect the skin and coat, but will also correct any damage incurred. Counter–flea products by themselves create a drying of the skin. Atopic or allergic dermatitis may also be produced by a flea–bite before the counter-flea product is used or takes effect. Therefore, as acceptance and use of these counter–flea products takes place, the marketing opportunity to veterinarians is to prescribe and sell Ceapro products.

Ceapro has conceived a system of products, developed by scientists and veterinarians, that addresses the immediate and long-term dermal needs of companion animals. Each product is an integral part of a complete health plan.

Oat Shampoo Hydrocolloidal Gel (Dr. Redmond's Oat Shampoo): The combination skin gel, coat shampoo, and conditioner is unique in its ability to deliver supernormal levels of oat β glucan hydrocolloid and active extracts. Hydrocolloidal Gel is a soap free, hypo–allergenic cleansing gel used to treat the problem, then to maintain healthy skin and a shiny coat. Additional products based on the hydrocolloidal gel platform are in development. These include antimicrobial and antipruritic shampoos.

Ear Cleanser: A gentle and effective cleanser containing oat active extracts to reduce redness and itching associated with otic irritation.

Hot–Spot Spray: Concentrated oat active extracts in a moisturizing base for the treatment of irritations between baths or when bathing is not practical.

Essential Oil Nutraceutical: A balanced combination of oat oil together with plant ω3 and ω6 essential oils for the development and maintenance of healthy skin and a shiny coat. The product includes oat oil for anti-oxidants and tocopherols/tocotrienols

The issue and challenge for the distributors and marketers of the Ceapro products is to communicate effectively the performance advantages of these products. Pricing of the Ceapro products is and will be competitive with the Virbac products.

The launch of the Ceapro product in Japan has provided significant learning relative to a communications strategy. This learning will be incorporated into the new partners' communications strategy.

On August 3rd 1998 at the Canadian Embassy in Tokyo, the global launch of Dr. Redmond's Oat Shampoo took place before a distinguished audience of federal officials, veterinarians, and corporate executives from Nippon Zenyaku Kogyo Company Limited, Daisen Sangyo Company Limited, and Ceapro Inc.

Preceding the launch reception, Dr. Redmond presented a seminar on the technical background and clinical efficacy of oat products developed specifically for veterinary use.

Sales of the product reflect market acceptance and a penetration rate of 20% of Japanese veterinary clinics was achieved before the end of 1998. In 1999 the Japanese range will be extended to include a 4-litre pump dispenser in addition to the 380 ml bottles.

Based on the strength of Japanese sales and the recommendation of Nippon Zenyaku senior management, negotiations for Australian distribution have commenced for a launch in fall 1999.

European marketing discussions required the performance of clinical trials. This has been completed for both the dermal coat therapy and ear cleanser. Ceapro products surpassed the performance of the leading French product.

Partnerships

Ceapro has formed a value-chain which allows bulk-raw materials to be obtained. The value-chain provides for the provision of specific oat varieties, the production of oat bran, starch, and protein as well as the contract manufacturing of the animal health and diabetes test products.

In all cases Ceapro quality standards are strictly applied. An essential aspect of Ceapro's development has been the establishment of quality control parameters to ensure both consistency and product quality.

Alberta Agriculture, Food and Rural Development

Ceapro itself is conducting the production of oat intermediates. The production takes place at the Government of Alberta Agriculture, Food and Rural Development Food Processing Development Centre (FPDC) in Leduc.

The net result of new production methods has been:

- Increased efficiency
- Decreased labour requirement
- Decreased capital costs
- Increased quality output, exceeding industry standards

The FPDC is a modern, fully equipped pilot plant and product development laboratory facility. The centre is staffed with scientists, engineers, and technologists experienced in agricultural processing and the development of specialized products to meet the demands of the domestic and international marketplace. Centre specialists work with Ceapro and provide in-plant technical consultation and advisory services in trouble shooting, quality control/quality assurance, product development, plant start-up, and process or equipment modifications. Services and facilities are provided on a confidential contractual basis.

The pilot plant equipment simulates industrial production to allow the assessment and evaluation of product and process performance. Private industry is invited to utilize the pilot plant for limited production on an interim basis. The plant is operated under Agriculture and Agri-Food Canada standards and is an establishment registered with the Canadian Food Inspection Agency.

Ceapro's relationship with FPDC dates to 1995 when the centre's food scientists were responsible for the formulation of the diabetes test meal bars used in clinical trials and proof of concept studies. The FPDC was also responsible for the production of prototype functional foods containing high fibre oat bran and β glucan.

Dragoco Gerberding & CO. Ag

In early February, 1999, Ceapro concluded an agreement with Dragoco Gerberding of Holzminden, Germany. Dragoco is one of the leading international suppliers of fragrance compositions, flavours, and cosmetic raw materials and active ingredients. Founded in 1919, this company is active around the globe. In 1997, Dragoco achieved total sales of 560.0 M DM of which 467.0 M DM were outside of Germany. The cosmetics division is the newest component of the company and in 1999, the division is expected to achieve approximately 75.0 M DM in sales. Its primary strength is Europe and Dragoco has recently focused this division on North America. Dragoco's success has been achieved through a commitment to research, creation of new products and processes, a dedication to quality and an effective marketing approach which focuses on the development of long term partnerships. Ceapro provides Dragoco with a broader range of products and, therefore, an opportunity to obtain a larger share of the business, particularly with larger multinational cosmetics companies.

Nippon Zenyaku Kogyo Co. Ltd.

Nippon Zenyaku is the largest Japanese animal health company. Its business activities are the manufacture and sale of medical supplies, particularly animal health products.

Nippon Zenyaku's exacting commitment to quality and safety, which has earned the company a distinguished reputation throughout Japan among veterinarians and members of the livestock industry.

With a desire to address individual customer needs, Nippon Zenyaku produces a wide variety of distinctive products and maintains an ongoing assurance of excellence and quality. To this end, Nippon Zenyaku conducts research based on the concept of comprehensive animal healthcare and improved productivity.

To augment its own research efforts, Nippon Zenyaku has forged links with global animal health companies, for example Merial (Frontline™) and Iams (Eukanuba Veterinary Diet).

In August 1998, Nippon Zenyaku launched Dr. Redmond's Oat Shampoo as a premier product for the treatment of companion animal dermatological conditions.

Ultravena Industries Inc.

Ultravena is a privately owned corporation formed to specifically market latex gloves coated with 'oat powder'. Ultravena have conducted clinical trials that demonstrated that oat powdered gloves significantly reduce redness, swelling, itching, and burning. The FDA have approved the oat powdered gloves as a medical device.

Ultravena currently serves the North American glove market through direct sales. It is the company's intention to expand the markets through license agreements with major medical product distributors.

Agricore Cooperative Inc.

Agricore is a dynamic, farmer-focused agri-business working to secure current and future opportunities for prairie farmers. Agricore owns facilities in British Columbia, Alberta, Saskatchewan, and Manitoba, and is a joint-venture partner in grain terminals on the west coast of Canada and Thunder Bay.

AgriCore develops and grows grain seeds – wheat and barley, oil seeds – flax and canola, and special crop seeds – beans, buckwheat, mustard, peas, and oats. Agricore is conducting field trials with Ceapro to provide seed varieties with enhanced phytopharmaceutical content.

In January 1997, Agricore (then the Alberta Pool) invested $4 million in Ceapro and entered into a strategic alliance with Ceapro for the supply of oats.

Daisen Sangyo Co. Ltd.

Daisen is Ceapro's agent in Japan and was an early investor in Ceapro. Daisen's function and commitment is to develop market opportunities for Ceapro products in Japan. As such, Daisen developed the relationship with Nippon Zenyaku.

CEAPRO INC.

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1998

AUDITORS' REPORT

To: The Shareholders of
CEAPRO INC.

We have audited the balance sheet of **Ceapro Inc.** as at December 31, 1998, and the statements of loss and deficit and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1998, and the results of its operations and its cash flows for the year then ended in accordance with generally accepted accounting principles.

The financial statements as at December 31, 1997, and for the year then ended, were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 26, 1998, (except for note 20, which was dated May 26, 1998).

Stout + Company

Chartered Accountants

Edmonton, Canada
February 17, 1999

CEAPRO INC.

BALANCE SHEET - DECEMBER 31, 1998

	1998	1997
ASSETS		
CURRENT ASSETS		
Cash	$ 7,329	$ 18,043
Accounts receivable	80,080	225,815
Inventory	8,169	3,895
Prepaid expenses	28,161	77,154
Loan receivable (note 4)	50,000	-
	173,739	324,907
LONG-TERM INVESTMENT AND LOAN RECEIVABLE (note 4)	-	6,612,598
CAPITAL ASSETS (note 5)	122,952	171,236
INTANGIBLE ASSETS (note 6)	182,655	5,978,901
	$ 479,346	$ 13,087,642
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (note 2)	$ 1,261,314	$ 2,242,914
Loans payable (note 7)	256,411	100,000
Current portion of long-term debt	8,348	1,072,660
	1,526,073	3,415,574
LONG-TERM DEBT (note 8)	41,652	260,400
	1,567,725	3,675,974
SHARE CAPITAL AND DEFICIT		
SHARE CAPITAL (note 9)	43,847,098	40,087,472
DEFICIT	(44,935,477)	(30,675,804)
	(1,088,379)	9,411,668
	$ 479,346	$ 13,087,642

Going concern (note 2)

See accompanying notes

Approved On Behalf Of The Board

Director ____________ Director John Zupancic

CEAPRO INC.

STATEMENT OF LOSS AND DEFICIT

YEAR ENDED DECEMBER 31, 1998

	1998	1997
Sales (note 12)	$ 399,934	$ 2,335,066
Cost of sales	67,250	1,853,311
Gross margin	332,684	481,755
Expenses		
General and administrative	1,135,995	4,179,116
Research and development	780,649	2,271,718
Interest on long-term debt	111,770	224,835
Amortization of intangible assets	62,885	1,028,315
Amortization of capital assets	39,548	1,182,261
Dividends on Class B preferred shares of subsidiary	-	564,088
Operations and quality control	-	879,774
	2,130,847	10,330,107
Loss before the following	(1,798,163)	(9,848,352)
Interest and other income (expenses)	41,322	(90,695)
Write-off of long-term investment (note 4)	(6,586,427)	-
Write-down of loan receivable (note 4)	(158,389)	-
Write-down of intangible assets (note 6)	(5,758,016)	(9,854,169)
LOSS FOR THE YEAR	(14,259,673)	(19,793,216)
Deficit at beginning of year	(30,675,804)	(10,882,588)
DEFICIT AT END OF YEAR	$ (44,935,477)	$ (30,675,804)
LOSS PER SHARE	$ (0.79)	$ (1.27)

Going concern (note 2)

See accompanying notes

CEAPRO INC.

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 1998

	1998	1997
OPERATING ACTIVITIES		
Loss for the year	$ (14,259,673)	$ (19,793,216)
Add (deduct) items not affecting cash		
Amortization	102,433	2,210,576
Write-down of intangible assets	5,758,016	9,854,169
Write-down of loan receivable	158,389	-
Write-off of long-term investment	6,586,427	-
Accrued redemption premium on Class B preferred shares of subsidiary	-	300,000
Loss on disposal of capital assets	783	-
Other	-	189,860
	(1,653,625)	(7,238,611)
Net change in non-cash working capital items	(891,146)	2,621,977
	(2,544,771)	(4,616,634)
INVESTING ACTIVITIES		
Investments and loans receivable:		
Vexco Healthcare Inc.	-	(13,837,355)
Canamino Inc.	(223,829)	(2,706,604)
Reduction of loan receivable	41,611	-
Purchase of capital assets	(1,287)	(990,019)
Proceeds on disposal of capital assets	9,240	-
Additions to intangible assets	(24,655)	(553,359)
	(198,920)	(18,087,337)
FINANCING ACTIVITIES		
Increase (decrease) in loans payable	256,411	(224,010)
(Decrease) increase in long-term debt	(1,283,060)	710,584
Issue of share capital of subsidiary	-	163,918
Issue of common shares	3,759,626	21,237,317
	2,732,977	21,887,809
Decrease in cash	(10,714)	(816,162)
Deconsolidation of Canamino Inc.	-	919,573
Cash (bank indebtedness) at beginning of year	18,043	(85,368)
CASH AT END OF YEAR	$ 7,329	$ 18,043

See accompanying notes

1. NATURE OF BUSINESS OPERATIONS

Ceapro Inc. (the "company") was incorporated under the Business Corporations Act of Alberta. The company's primary business activities relate to the development of various innovative life sciences products and processes relating to oat fractionation technology.

On May 5, 1998, control of the company's wholly owned subsidiary, Canamino Inc. ("Canamino") was assumed by Canamino's Class B preferred shareholder due to default of payment of dividends due in October, 1997, and the failure to redeem 500,000 Class B preferred shares as required under the subscription agreement. Control was gained through the assumption of 51% of the voting entitlement attached to the Class A common shares.

2. GOING CONCERN ASSUMPTION

These financial statements have been prepared on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. However, the company has experienced significant operating losses and its ability to continue operations is dependent upon achieving profitability or securing additional financing. The use of generally accepted accounting principles that are applicable to a going concern may be inappropriate because there is significant doubt about the appropriateness of the going concern assumption.

On February 27, 1998, the company obtained an order of the Court of Queen's Bench of Alberta pursuant to the Companies Creditors Arrangement Act to facilitate a restructuring of its unsecured debt. On March 2, 1998, the company submitted a formal plan of arrangement whereby it proposed to pay its unsecured creditors with a claim of greater than $1,000 payment of one third of their claim in cash and two thirds in Class A shares of the company based on a share price of $1.25. Unsecured creditors with a claim of less than $1,000 were proposed to be paid in cash only. On March 25, 1998, the unsecured creditors voted to accept the plan of arrangement. On May 26, 1998, an Order of the Court of Queen's Bench of Alberta was issued approving the plan and the shares were issued (see note 9). As at December 31, 1998, the company has not paid the cash component of $969,208 of the plan of arrangement.

These financial statements do not give effect to adjustments to the amounts and classifications of assets and liabilities that would be necessary should the company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities and commitments at amounts different from those in the accompanying financial statements.

3. ACCOUNTING POLICIES

(a) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses during the reported period. By their nature, these estimates are subject to measurement uncertainty and the effect on these and future financial statements of changes in such estimates could be significant.

(b) Inventory

Inventory of raw materials is valued at the lower of cost and replacement cost on a first-in, first-out basis.

Inventory of work in progress and finished goods is valued at the lower of cost and net realizable value on a first-in, first-out basis.

(c) Capital assets

Capital assets are recorded at cost and are amortized over their estimated useful lives as follows:

Furniture and equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold improvements	25% straight-line

(d) Intangible assets

Goodwill, patents and trademarks are recorded at cost less accumulated amortization. Amortization is recorded on a straight-line basis over a period ranging from 5 to 20 years commencing the later of the year commercial production is achieved or the patent or trademark is granted.

The company continually evaluates whether events and circumstances have occurred that indicate the remaining useful life of intangible assets may warrant revision or that the remaining balance may not be recoverable. The company uses an estimate of undiscounted operating income and related cash flows over their remaining useful life to determine whether the carrying amounts of these assets are recoverable. If management's assessment or other facts and circumstances pertaining to the recoverability of such assets were to change, the company will adjust the carrying values as appropriate and charge such costs to operations.

Due to the long-term nature of estimates inherent in determining future cash flows and the useful life of these assets, it is reasonably possible the estimated recoverable amount of these assets could be reduced in the future.

3. ACCOUNTING POLICIES (continued)

(e) Foreign currency translation

Revenue and expense transactions have been translated to their Canadian dollar equivalent using the average exchange rate for the period.

Current monetary assets and liabilities are translated to their Canadian dollar equivalent at the rates effective at the balance sheet date.

Foreign exchange gains or losses are recorded in the statement of loss and deficit.

(f) Income taxes

The liability method of tax allocation is used in accounting for income taxes. Under the liability method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax basis (temporary differences). Future income tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the year in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that includes the enactment date. Future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is provided.

(g) Loss per share

Loss per share is calculated based on the weighted average number of shares outstanding during the year. Fully diluted loss per share when antidilutive is not disclosed.

4. LONG-TERM INVESTMENT AND LOAN RECEIVABLE

	1998	1997
Canamino Inc.		
Shares, at cost	$ -	$ 1,779,886
Loan receivable	-	4,582,712
Employee loan receivable	50,000	250,000
	50,000	6,612,598
Less current portion	50,000	-
	$ -	$ 6,612,598

On May 5, 1998, Canamino's Class B preferred shareholder took effective control due to certain defaults in the subscription agreement (see note 1). On October 1, 1998, Canamino was placed into receivership. As a result, the company has written off its investment in Canamino and related loans totalling $6,586,427.

Subsequent to the year end, as a condition of settlement of an employment contract, the employee paid $50,000 to the company. The balance of the loan receivable was written down to the net realizable value of $50,000.

5. CAPITAL ASSETS

	1998			1997
	Cost	Accumulated amortization	Net	Net
Furniture and equipment	$ 126,686	$ 48,031	$ 78,655	$ 108,569
Computer equipment	94,313	52,837	41,476	58,906
Leasehold improvements	5,333	2,512	2,821	3,761
	$ 226,332	$ 103,380	$ 122,952	$ 171,236

6. INTANGIBLE ASSETS

	1998			1997
	Cost	Accumulated amortization	Net	Net
Patents and trademarks	$ 182,655	$ -	$ 182,655	$ 366,888
Goodwill	-	-	-	5,612,013
	$ 182,655	$ -	$ 182,655	$ 5,978,901

During the year the company reviewed the carrying value of certain intangible assets by comparing expected future operating cash flows to the unamortized values of such assets. The company also considered other factors such as current operating results, future uncertainties with respect to supply of raw materials and changes in technology.

As a result of the review, the company wrote down the carrying value of intangible assets in the amount of $5,758,016.

7. LOANS PAYABLE

	1998	1997
Loans payable to shareholders, secured by a general security agreement with interest at 10%.	$ 57,911	$ -
Loan payable, unsecured, without interest.	98,500	-
Loan payable, unsecured, without interest.	100,000	100,000
	$ 256,411	$ 100,000

8. LONG-TERM DEBT

	1998	1997
Bank loan	$ -	$ 1,000,000
Capital lease	-	184,560
Loan payable, unsecured, without interest	-	98,500
Loan, unsecured, payable $3,113 per quarter principal and interest at prime plus 2%, commencing March, 1999, due December, 2003.	50,000	50,000
	50,000	1,333,060
Less current portion	8,348	1,072,660
	$ 41,652	$ 260,400

Principal payments on the loan payable due in the next five years are as follows:

1999	$ 8,348
2000	9,102
2001	9,925
2002	10,823
2003	11,802
	$ 50,000

9. SHARE CAPITAL

(a) Authorized
Unlimited number of Class A voting common shares
Unlimited number of Class B non-voting common shares

(b) Issued - Class A common shares

	1998		1997	
	Number of shares	Amount	Number of shares	Amount
Balance at beginning of year	16,184,078	$ 36,024,639	20,223,535	$ 18,540,955
Share exchange pursuant to plan of Arrangement	-	-	(10,111,768)	-
	16,184,078	36,024,639	10,111,767	18,540,955
Issued during the year for:				
Cash	2,447,187	1,957,750	600,000	615,000
Special warrants	800,000	4,000,000	15,557	32,403
Partial settlement of unsecured creditors (see note 2)	1,305,500	1,631,876	-	-
Services rendered	354,250	232,833	167,651	349,625
Acquisitions	-	-	5,289,103	16,543,959
Share issuance costs	-	-	-	(57,303)
	4,906,937	7,822,459	6,072,311	17,483,684
	21,091,015	43,847,098	16,184,078	36,024,639
To be issued	-	-	41,889	62,833
	21,091,015	43,847,098	16,225,967	36,087,472
Special warrants	-	-	800,000	4,000,000
Balance at end of year	21,091,015	$ 43,847,098	17,025,967	$ 40,087,472

9. SHARE CAPITAL (continued)

(c) Stock options outstanding at December 31, 1998, were as follows:

Exercise price	Number of options	Year of expiration
$1.00	1,246,667	2003
$1.00	320,000	2004
$1.35	11,111	2003
	1,577,778	

(d) Warrants outstanding at December 31, 1998, were as follows:

Exercise price	Number of common shares	Year of expiration
$1.00	1,248,594	2000
$1.25	600,000	1999
$5.00	400,000	1999
	2,248,594	

10. COMMITMENTS

(a) The company rents premises and equipment under long-term operating leases. Future minimum annual lease payments, excluding operating costs, are as follows:

	1999	2000	2001	2002
Premises	$ 71,424	$ 71,424	$ 71,424	$ 23,808
Equipment	13,195	7,523	1,925	311
	$ 84,619	$ 78,947	$ 73,349	$ 24,119

(b) Pursuant to a technology license agreement, the company has exclusive rights to certain patents and trade secrets. The license expires on the later of the date of expiration of the last remaining patent or 10 years from the date of first commercial sale of the licensed product which is defined as a calendar month with sales greater than $50,000.

As a condition of the technology license agreement, the company has agreed with the University of Saskatchewan (U of S) that by June 30, 2000, it will effect payment to the U of S for a minimum of $500,000 for research and development to be conducted at the U of S, of which not less than $300,000 shall be effected by May 1, 1998. As at December 31, 1998, no amounts have been paid.

11. CONTINGENT LIABILITY

(a) The company has guaranteed the payment of royalties by Canamino to an unrelated third party. The royalty agreement of Canamino required it to pay royalties calculated as the greater of 3% of Canamino's sales or the following annual amounts:

1997	$ 75,000
1998	200,000
1999	200,000
Thereafter	250,000

As at December 31, 1998, no payments have been made.

(b) Pursuant to a letter of undertaking dated June 9, 1995, the company agreed with the Royal Bank of Canada, a lender to Canamino, to provide sufficient funds to Canamino to service loans and prevent covenant breaches of Canamino should this become necessary.

On October 1, 1998, Canamino was placed in receivership and on January 19, 1999, the Royal Bank of Canada made a demand of $2,718,000 on the company. The company refutes the claim and has sought legal counsel as to a possible counter claim.

12. SALES

Substantially all sales are export sales.

13. RELATED PARTY TRANSACTIONS

Related party transactions during the year not otherwise disclosed in these financial statements are as follows:

	1998	1997
Transactions with directors, shareholders and employees		
Consulting fees paid to a director	$ -	$ 15,000
Loans payable to shareholders	57,911	-
Interest paid to a director or shareholder	18,100	2,712
Amount payable to directors included in accounts payable and accrued liabilities	34,334	-
Amount receivable from an employee and included in accounts receivable	55,315	53,797
Amounts payable to employees included in accounts payable and accrued liabilities	11,618	-

These transactions are considered to be in the normal course of business operations and are recorded at fair market value.

14. INCOME TAXES

(a) Non-capital losses

The company has accumulated non-capital losses carried forward for income tax purposes amounting to approximately $10,599,000, the benefit of which has not been reflected in these financial statements. These losses may be applied against future taxable income within the limitations prescribed by the Income Tax Act and expire as follows:

1999	$ 640,000
2000	854,000
2001	1,326,000
2002	1,889,000
2003	2,024,000
2004	2,118,000
2005	1,748,000
	$ 10,599,000

(b) Net capital losses

The company has net capital losses of $5,105,514, which can be carried forward indefinitely to offset future taxable capital gains.

(c) Scientific research and experimental development (SR & ED)

The company has an accumulated SR & ED expenditure pool of $1,322,407, which can be carried forward indefinitely to be applied against future taxable income.

The company has accumulated SR & ED investment tax credits in the amount of $311,161. These credits may be applied against future federal income taxes payable and expire as follows:

2004	$ 25,574
2005	65,822
2006	37,857
2007	181,908
	$ 311,161

14. INCOME TAXES (continued)

(d) Temporary differences

A future income tax asset reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the company's future tax assets as at December 31, 1998, are as follows:

Deductible temporary differences:

Non-capital losses and SR & ED expenditures carried forward	$ 11,921,407
Deductible refinancing and share issue costs	79,087
Undepreciated capital cost for tax purposes in excess of net book value	127,514
Tax value of intangible assets in excess of amounts recorded in financial statements	2,775,866
	$ 14,903,874

For financial statement purposes, no future income tax asset has been recorded at December 31, 1998.

15. SUBSEQUENT EVENTS

On February 5, 1999, the company entered into an agreement for the distribution of specific products. The agreement requires two payments of $100,000 US each to the company upon successful completion of two product testing milestones. The definition of these milestones and the determination as to successful completion are to be determined by the payer.

Subsequent to the year end, the company made an application to the Alberta Stock Exchange to issue shares in settlement of $64,355 owing to members of the Board of Directors and employees at December 31, 1998 for services rendered.

16. FINANCIAL INSTRUMENTS

Financial instruments of the company consist mainly of cash, accounts receivable, loan receivable, accounts payable and accrued liabilities, loans payable and long-term debt. As at December 31, 1998, there are no significant differences between the carrying amounts of these items and their estimated market values.

17. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the company's ability to conduct normal business operations. It is not possible to be certain that all aspects of the year 2000 Issue affecting the company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

18. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with financial statement presentation adopted for the current year.

Investor Information

LEGAL COUNSEL:

Bryan and Company
Edmonton, Alberta

AUDITORS:

Stout & Company
Edmonton, Alberta

REGISTER AND TRANSFER AGENT:

Montreal Trust Company of Canada
6th Floor, 530 - 8th Avenue S.W.
Calgary AB T2P 3S8

STOCK EXCHANGE LISTING

Shares of the Company are listed on the Alberta Stock Exchange under the Trading Symbol CZO

SHAREHOLDER INQUIRES

For information about the Company, Shareholders or prospective Shareholders are invited to contact

Kenneth Pilip
Telephone: 780.421.4555
Telefacsimile: 780.421.1320
Email: info@ceapro.com

Directors, Officers, and Advisors

Board of Directors

John Zupancic
Chairman of the Board

Robert A. Binnendyk
President and Chief Executive Officer
Ceapro Inc.

John Yewchuck
President and Chief Executive Officer
Thermo King Western Ltd.

Daniel Koyich
President
JeanDan Management Ltd.

Officers and Corporate Management

Robert A. Binnendyk
President and Chief Executive Officer

Douglas Clement
Vice President
Business Development

Dr. Mark Redmond
Vice President
Scientific and Regulatory Affairs

Carol Palmason
Senior Vice President
Pharmaceuticals

Milica Stolic
Controller

Scientific Advisory Board

Dr. James Murray
University of Alberta

Dr. Eric Swanson
National Research Council of Canada

CEAPRO

INC.

Suite 2830, 10180-101 Street
Edmonton AB T5J 3S4

Telephone: 780.421.4555 Telefacsimile: 780.421.1320
Email: info@ceapro.com

www.ceapro.com